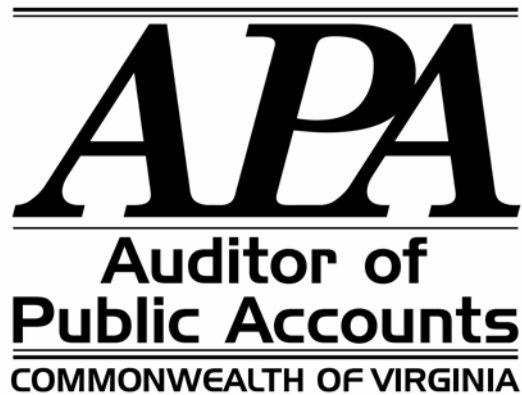


VIRGINIA STATE UNIVERSITY

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2005**



AUDIT SUMMARY

Our audit of Virginia State University for the year ended June 30, 2005, found:

- the financial statements are presented fairly, in all material aspects;
- internal control matters that we consider to be reportable conditions; however, we do not consider any of these to be a material weakness;
- no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards; and
- the University has not completed adequate corrective action with respect to the previously reported finding "Document Policies and Procedures." Adequate corrective action has been taken with respect to audit findings reported in the prior year that are not repeated in this report.

In this report, we also provide a discussion of the status of Project New Horizons, the University's implementation of the new Banner administrative systems, with updated recommendations.

We recommend that the University improve:

- the testing and updating of their disaster recovery plan;
- documentation of Human Resources operating policies and procedures;
- the process used to reconcile capital assets to the accounting system; and
- compliance with small purchase charge card policies.

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UNIVERSITY RESPONSE

UNIVERSITY OFFICIALS

STATUS OF PROJECT NEW HORIZONS

We have continued to monitor Virginia State University's progress in implementing their new Banner administrative systems, Project New Horizons. They are scheduled to implement the Banner Finance module, which is one in a series of modules, on July 1, 2006.

In August 2005, we released a report titled, "Interim Report of Virginia State University's Project New Horizons" which addressed implementation issues. The report recommended corrective action to mitigate the effect of these issues on a successful implementation. Below, we provide a discussion of what action the University has taken since our initial report and provide updated recommendations. The University has worked hard to address the issues we reported previously and we commend their efforts, but much work remains for the successful implementation of the Finance module on schedule.

Address Staffing Shortages

To address staffing shortages, the University has gone from a decentralized project team to a concentrated core team approach to complete the work. This approach has increased productivity and University staff believes it has made them more efficient. Additionally, the University discontinued the consulting services of Collegis and has contracted with SCT. The University has hired a full-time Chief Information Officer (CIO) with experience implementing higher education systems.

Staffing shortages are a continuing project risk, even with the organizational changes. Two key individuals recently left the University and although one plans to return on a consulting basis, we have concerns that this turnover and any other unforeseen staffing events could negatively affect the project timeline.

Improve Project Oversight

The University has not hired a full-time committed project manager to run the daily management of the project. Soon after we released our August 2005 report, the project manager resigned and the University subsequently hired the CIO, who has also been acting as project manager along with her other responsibilities.

Although the University actively pursued candidates for the project manager role, the process took longer than desired. In late-March 2006, the University hired a project manager. Having a full-time, committed project manager should improve the management of the Banner project.

Manage Against a Project Plan

In addition to hiring SCT, the University has also hired a contract employee to assist them in producing project documents and a baseline project plan. The project plan we reviewed in August 2005 did not meet the project's needs. In January 2006, the Executive Steering Committee approved an enhanced version.

Since its approval, the project team continues to rework the project plan, which compromises the project plan's reliability as a source for determining the status of the project. Although the CIO and SCT assure us that the project is on schedule and delivery will occur as planned, we cannot rely on the project plan to verify the schedule and completion of work. Best practices recommend developing a project plan early in the project and managing the project to the plan.

Enforce Accountability for Work

Although there is a revised project plan and a new core team approach, we have continuing concerns that the project team will not complete the remaining work on time. The University previously reviewed the scheduled tasks and moved some tasks, such as Budget Development functionality, to start after the system goes live on July 1. What remains in the schedule is all work necessary for sufficient systems testing to occur by April 1, so the University can go live on July 1.

Our review of the project plan and discussion with the CIO and SCT notes several tasks that are late and could impact system testing. With no more functionality left to cut from the schedule, our concern is that in order to meet the implementation schedule, the University may reduce their testing effort. The implementation schedule is extremely tight and has little, if any, slack built in for delayed tasks. The University should take care not to sacrifice system testing to compensate for delayed work.

Improve Lack of Internal Audit Oversight

The University has resolved this prior finding. The Internal Audit IT Audit Supervisor returned to the Internal Audit department in August 2005 to provide leadership in that department while the University took actions to secure an Internal Audit Director. The IT Audit Supervisor served as an active participant in internal oversight for the project by attending meetings, training, and business processes re-engineering sessions. In September 2005, Internal Audit performed a mid-quarter Independent Verification and Validation (IV&V) review on the project to assess its progress and provide recommendations.

Recently the University selected a new Chief Audit Executive that previously served as the University's Associate Vice President for Administration and Finance and was involved with the project's Executive Oversight Committee. She now monitors the project and attends the Executive Oversight Committee meetings. In this role, she serves as internal advisory oversight for the project at the Executive Oversight Committee.

Recommendation

The University plans to start using the Banner Finance module in about three months. The University's original plan had all work finished by April 1 and the final three months to test the system, correct identified problems, complete user training, and write user manuals. This is a significant amount of work in a short period of time.

Currently, there are risks to the project that the University must continue to closely monitor and manage to achieve success. These risks include: addressing staffing issues, not completing tasks on schedule, and correcting problems identified during system testing. The CIO is aware of these risks and is closely monitoring them, but we have concerns that the University has not documented them in a risk response plan. Without an updated plan addressing the current risks, we do not know that the project team and University management understand what would happen if the risks occur or increase, or if the current response strategy fails.

Given the limited time remaining, management does not need an elaborate plan that takes a significant amount of time to document. We believe preparing a risk response plan could involve a simple discussion and documentation of the current risks and how the University will respond to them. For example, what will the University do if it appears user manuals completion will not occur by July 1? Would this failure delay the implementation? If not, what is the plan for how employees will do their work?

While the University is confident that the system will go live as scheduled on July 1, we remain cautious. Project New Horizons is at a critical stage and there is still a significant amount of work that needs to be done in a short period of time. With no remaining slack in the project schedule to absorb delays, every delay could result in decreased system testing or error resolution.

Other Commonwealth universities that have recently implemented Banner have experienced problems performing reconciliations and preparing financial reports. These problems have put a strain on these universities limited resources. To avoid similar problems, it is important that the University implement a quality system. Quality is ensured by thoroughly testing the system and allowing time to resolve errors and retest before going live.

INTERNAL CONTROL AND COMPLIANCE FINDINGS AND RECOMMENDATIONS

Test and Update Disaster Recovery Plan

The University has not performed a full test of its systems disaster recovery plan and then updated that plan based on the results of the test. The University completed a limited test of the recovery plan in Spring 2004. COV ITRM Standard SEC 2001-01.1 states that “Agencies shall develop, document, maintain and periodically test a business continuity plan that will provide a reasonable assurance that critical data processing support can be continued, or resumed within an acceptable time frame, if normal operations of the system are interrupted.” Industry best practices call for testing and updating the disaster recovery plan annually.

The University should test and update their disaster recovery plan at least annually in accordance with state requirements and University policies. With a tested and updated systems disaster recovery plan, the University will be better prepared to restore critical business system functions in the event of a disaster. Additionally, as changes to the systems environment are included in the recovery plan, the University will be better prepared to resume system operations as they existed before the disaster.

Document Human Resource Policies and Procedures

In the prior audit, we noted that the University did not have documented policies and procedures for the Human Resources department. The University has since started to document policies and procedures, but has not completed this task. Although we did not note any exceptions during the audit due to the lack of documented policies, it is important that the University complete documenting its procedures for managing human resources. The lack of documented policies and procedures increases the risk that good hiring and personnel procedures may not be consistently applied.

We recommend that the Department continue to document critical operating policies and procedures to ensure continuity of operations in the event of loss of key personnel, which the University has recently experienced.

Improve Capital Asset Reconciliation Procedures

The University’s general accounting staff does not correct errors in the statewide Fixed Asset Accounting and Control System (FAACS) promptly. Most of these errors relate to previous years and some date back as far as 1997. Not resolving these errors promptly leads to persistent errors in the system, errors in the University’s accounting system, and unnecessary work in preparing the monthly reconciliations between FAACS and the financial accounting system. Additionally, neither FAACS nor the financial accounting system contains an accurate balance of the University’s capital assets. These systems provide important information to central agencies and University management and provide an essential control to assist the University in ensuring that its accounting system is accurate.

We recommend that the University revise its procedures to reconcile capital asset account balances and transactions between its financial accounting system and FAACS. The University should also make certain that a sufficient review process is in place to ensure that the systems are promptly reconciled and corrected. Promptly resolving reconciling items and maintaining accurate account balances in both University-based and statewide systems will make accurate information promptly available to management and all decision makers and improve the accuracy of the University’s financial reports. Additionally, this should also reduce University resources required to complete this essential reconciliation.

Improve Compliance with Small Purchase Charge Card Policies

Two University employees divided a total of four purchases made with their small purchase charge cards to circumvent transaction limits. Supervisors completed the monthly review of the employees' charges, including the split payments, and took no action to correct the situation. Furthermore, the small purchase charge card administrator should have found the split payments during an annual review, but did not take corrective action with the employees.

While these purchases were necessary to the University's operations, these cardholders should have sought advanced permission to exceed their transaction limit, requested a permanent change to their transaction limit, or used a different method of payment for these purchases. Splitting purchases to circumvent small purchase charge card limits violates University and state policies and the lack of supervisory action related to these transactions represents a weakness in internal controls. Not following the University's policies related to transaction limits and supervisory review increases the risk for potential fraudulent activity.

We recommend that all employees and supervisors follow established University and state policies related to small purchase charge card transactions. Employees who deliberately circumvent transaction limits should be subject to disciplinary action and supervisors must assume a more active role in identifying split purchases and taking corrective action when they find that cardholders violate transaction limits. Management should also periodically review employees' job duties to ensure that their transaction limit is reasonable given the nature of their responsibilities.

MANAGEMENT'S DISCUSSION AND ANALYSIS

(unaudited)

Introduction

This discussion and analysis provides an overview of the financial position and results of activities of Virginia State University for the year ended June 30, 2005. Comparative information for the fiscal year ended June 30, 2004 has been provided where applicable. The financial statements referred to above were prepared in accordance with applicable pronouncements and statements of the Governmental Accounting Standards Board (GASB).

Effective with fiscal year 2004, the University implemented GASB Statement 39, *Determining Whether Certain Organizations are Component Units*. Under this standard, the Virginia State University Foundation (VSUF) and the Virginia State University Real Estate Foundation (VSUREF) are considered component units of the University. The financial data of these two foundations are presented separately in the Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets. Additional information regarding the foundations is included in the footnotes. The remainder of this Management's Discussion and Analysis excludes the foundations except where specifically noted.

Effective with fiscal year 2005, the University was required to implement GASB Statement 40, *Deposit and Investment Risk Disclosures*. This statement addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest rate risk, this statement requires certain disclosures of investments with fair values that are highly sensitive to changes in interest rates. Deposit and investment policies related to the risks identified in this statement must be disclosed. This standard also modifies disclosures required by GASB Statement 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*. Portions of that statement have been eliminated or modified.

Background

The University is one of two land grant institutions in the Commonwealth. As a land grant institution, the University engages in natural resource-related research projects and agriculture extension services. The University was founded in 1882, was designated a land grant institution in 1920, and attained University status in 1979. The University offers programs at the doctoral, graduate, and undergraduate levels in science, education, humanities, social sciences, and business. The University is governed by an 11-member Board of Visitors.

The University is a component unit of the Commonwealth of Virginia and is included in the basic financial statements of the Commonwealth. The Commonwealth's Comprehensive Annual Financial Report includes all agencies, boards, commissions, and authorities over which the Commonwealth exercises or has the ability to exercise oversight authority.

Financial Highlights

The University's financial position remained strong at June 30, 2005, with total assets of \$156,285,624 and liabilities of \$34,032,635 compared to total assets of \$148,868,389 and total liabilities of \$32,994,166 at June 30, 2004.

Net assets grew from \$115,874,223 at June 30, 2004 to \$122,252,989 at June 30, 2005. This is a 5.5 percent increase. The increase in net assets from operations and nonoperating revenues are summarized next.

Summary of the Increase in Net Assets *

	<u>2005</u>	<u>2004</u>	<u>Increase/(Decrease)</u>	
			<u>Amount</u>	<u>Percent</u>
Total operating revenue	\$ 53,007	\$ 48,086	\$ 4,921	10.2%
Total operating expenses	<u>88,095</u>	<u>79,597</u>	<u>8,498</u>	10.7%
Operating loss	(35,088)	(31,511)	(3,577)	11.4%
Nonoperating revenues	35,772	33,382	2,390	7.2%
Other revenue	<u>7,979</u>	<u>2,135</u>	<u>5,844</u>	273.7%
Total	<u>\$ 8,663</u>	<u>\$ 4,006</u>	<u>\$ 4,657</u>	116.3%

* in thousands

Comparing fiscal years 2004 and 2005, operating revenues increased by 10.2 percent while operating expenses increased by 10.7 percent. Nonoperating revenues increased by \$2.4 million (7.2 percent). After adding in other revenues, net assets increased by \$4.7 million in fiscal year 2005.

Using the Financial Statements

The University's financial report includes three financial statements: the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows. As stated earlier, these statements are prepared in accordance with GASB principles, which establish standards for external financial reporting for public colleges and universities. Under these principles, revenues and expenses are categorized as either operating or nonoperating. Operating revenues include such items as student tuition and fees, grants and contracts, and sales and services of auxiliary enterprises. Nonoperating revenues include state appropriations and investment income. Consequently, the operating loss of \$35,088,330 does not account for the normal nonoperating revenue sources, primarily state appropriations. By adding the nonoperating revenues, the adjusted income is \$683,685 excluding other revenues (capital appropriations and gifts and additions to permanent endowments).

Statement of Net Assets

The Statement of Net Assets presents the financial position of the University at the end of the fiscal year and includes all assets and liabilities of the University. The difference between the total assets and total liabilities, the net assets, is one indication of the current financial condition of the University, while the change in net assets is an indication of whether the overall financial condition of the University has improved or worsened during the year. Assets and liabilities are generally measured using current values. One notable exception is capital assets, which are stated at historical cost less an allowance for depreciation.

Net assets are classified into four major categories: invested in capital assets, restricted non-expendable net assets, restricted expendable net assets, and unrestricted net assets.

Invested in Capital Assets reflects the University's capital assets net of accumulated depreciation and any debt attributable to their acquisition, construction, or improvement.

Restricted Non-Expendable reflects the University's endowment and similar funds whereby the donor has stipulated that the gift principal is to be maintained and the income from the principal is to be used to support specific programs of the University.

Restricted Expendable reflects the University's endowment and similar funds whereby the donor has stipulated that the gift be used for specific programs of the University.

Unrestricted reflects a broad range of assets available to the University that may be used at the discretion of the Board of Visitors for any lawful purpose in support of the primary mission of education, research, and public service. These assets are derived from student tuition and fees, state appropriations, indirect cost recoveries from grants and contracts, auxiliary services sales, and donations.

A summary of the University's assets, liabilities, and net assets at June 30, 2004 and 2005, follows:

<u>Condensed Statement of Net Assets *</u>				
	<u>2005</u>	<u>2004</u>	<u>Increase/(Decrease)</u> <u>Amount</u>	<u>Percent</u>
Assets:				
Current assets	\$ 36,040	\$ 31,926	\$ 4,114	12.9%
Noncurrent assets				
Restricted cash and cash equivalents	31,538	30,883	655	2.1%
Investments	10,054	9,086	968	10.7%
Capital assets, net	76,262	74,552	1,710	2.3%
Other	<u>2,391</u>	<u>2,421</u>	<u>(30)</u>	(1.2)%
Total assets	<u>156,285</u>	<u>148,868</u>	<u>7,417</u>	5.0%
Liabilities:				
Current liabilities	18,012	15,847	2,165	13.7%
Noncurrent liabilities	<u>16,020</u>	<u>17,147</u>	<u>(1,127)</u>	(6.6)%
Total liabilities	<u>34,032</u>	<u>32,994</u>	<u>1,038</u>	3.1%
Net assets:				
Invested in capital assets, net of related debt	65,769	64,740	1,029	1.6
Restricted:				
Expendable	36,981	35,278	1,703	4.8
Nonexpendable	1,929	1,547	382	24.7
Unrestricted	<u>17,574</u>	<u>14,309</u>	<u>3,265</u>	22.8
Total net assets	<u>\$122,253</u>	<u>\$115,874</u>	<u>\$ 6,579</u>	5.7%

* in thousands

A review of the University's Statement of Net Assets at June 30, 2005, shows that the University continues to build and improve upon its financial condition. This financial condition reflects the prudent use of its financial resources, including budgetary controls, conservative utilization of debt and maintenance, and replacement of the physical plant.

Statement of Revenues, Expenses, and Changes in Net Assets

The Statement of Revenues, Expenses, and Changes in Net Assets presents the University's results of activities. Below is a summarized statement of the University's revenues, expenses, and changes in net assets for the years ended June 30, 2004 and 2005.

Condensed Statement of Revenues, Expenses, and Changes in Net Assets *

	<u>2005</u>	<u>2004</u>	<u>Increase/(Decrease)</u>	
			<u>Amount</u>	<u>Percent</u>
Operating revenues	\$ 53,007	\$ 48,086	\$ 4,921	10.2%
Operating expenses	<u>88,095</u>	<u>79,597</u>	<u>8,498</u>	10.7%
Operating loss	(35,088)	(31,511)	(3,577)	11.4%
Nonoperating revenues/(expenses):				
State appropriations	34,081	31,873	2,208	6.9%
Other nonoperating revenues and expenses	<u>1,691</u>	<u>1,509</u>	<u>182</u>	12.1%
Net nonoperating revenues and expenses	<u>35,772</u>	<u>33,382</u>	<u>2,390</u>	7.2%
Income before other revenues	684	1,871	(1,187)	(63.4%)
Capital appropriations	7,107	1,576	5,531	351.0%
Capital grants and gifts	568	469	99	21.1%
Additions to endowments	<u>303</u>	<u>90</u>	<u>213</u>	236.7%
Total other revenues	<u>7,978</u>	<u>2,135</u>	<u>5,843</u>	273.7%
Total increase in net assets	<u>8,662</u>	<u>4,006</u>	<u>4,656</u>	116.2%
Net assets, beginning of year	115,874	112,813	3,061	2.7%
Restatement	<u>(2,284)</u>	<u>(945)</u>	<u>(1,339)</u>	141.7%
Restated net assets, beginning of year	<u>113,591</u>	<u>111,868</u>	<u>1,723</u>	1.5%
Net assets, end of year	<u>\$122,253</u>	<u>\$115,874</u>	<u>\$ 6,379</u>	5.5%

* in thousands

As noted above, operating revenues for the University increased by 10.2 percent from the previous year and operating expenses increased by 10.7 percent. The operating loss for the University actually increased in fiscal year 2005, before recognition of nonoperating and other revenues. This loss was more than offset by these revenue sources, with net assets increasing by almost \$6.4 million. A large part of the overall increase in net assets in fiscal year 2005 resulted from increases in state appropriations.

Summary of Revenues

A summary of the University's revenues for the years ended June 30, 2004 and 2005 appears below:

Summary of Revenues *

	<u>2005</u>	<u>2004</u>	<u>Increase/(Decrease)</u>	
			<u>Amount</u>	<u>Percent</u>
Operating revenues:				
Student tuition and fees, net of scholarship allowance	\$16,016	\$13,843	\$ 2,173	15.7%
Federal, state, and nongovernmental grants and contracts	19,218	17,583	1,635	9.3%
Auxiliary enterprises, net of scholarship revenue	17,633	16,448	1,185	7.2%
Other operating revenue	<u>140</u>	<u>212</u>	<u>(72)</u>	(34.0%)
Total operating revenues	<u>53,007</u>	<u>48,086</u>	<u>4,921</u>	10.2%

Nonoperating revenues/(expenses):

State appropriations	34,081	31,873	2,208	6.9%
Gifts	1,628	1,303	325	24.9%
Other nonoperating revenues	<u>63</u>	<u>206</u>	<u>(143)</u>	(69.4%)
Total nonoperating revenues	<u>35,772</u>	<u>33,382</u>	<u>2,390</u>	7.2%

Capital revenues and gains:

Capital appropriations	7,107	1,576	5,531	351.0%
Capital gifts	568	469	99	21.1%
Additions to permanent endowment	<u>303</u>	<u>90</u>	<u>213</u>	236.7%

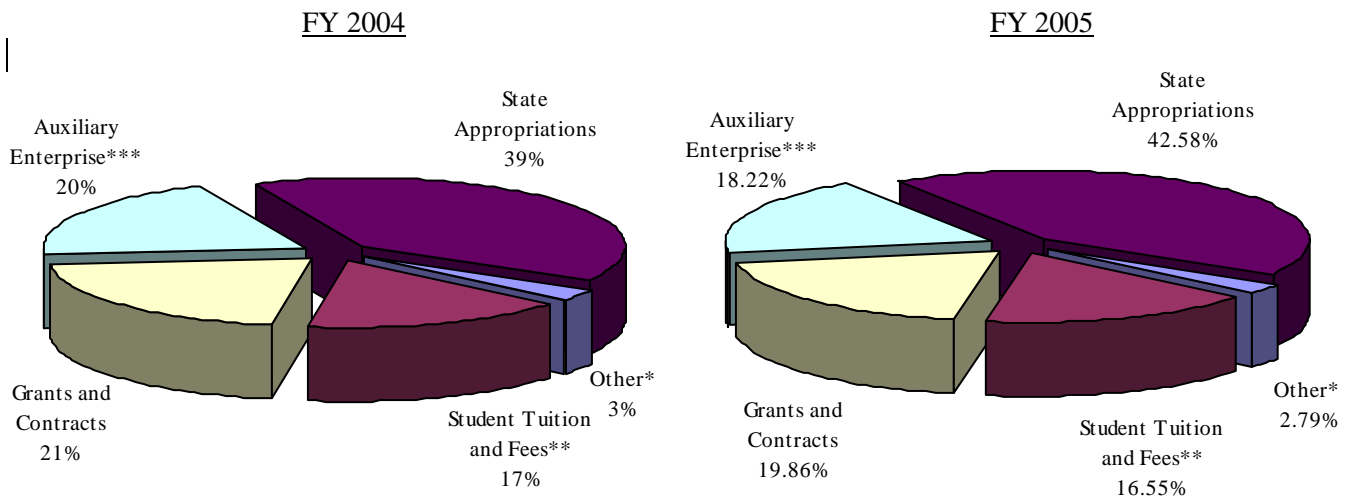
Total capital revenues	<u>7,978</u>	<u>2,135</u>	<u>5,843</u>	273.7%
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Total revenues	<u>\$96,757</u>	<u>\$83,603</u>	<u>\$13,154</u>	15.7%
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* in thousands

Total operating revenues increased by \$4.9 million (10.2 percent) in fiscal year 2005 compared to the previous year. The primary components of operating revenues increases are as follows: Tuition and fees increased by \$2.2 million (15.7 percent), which is due to an increase in enrollment and in tuition and fee rates; grants and contracts increased by \$1.63 million (9.3 percent); and sales and services of auxiliary enterprises increased by \$1.18 million (7.2 percent).

Summary of Revenues

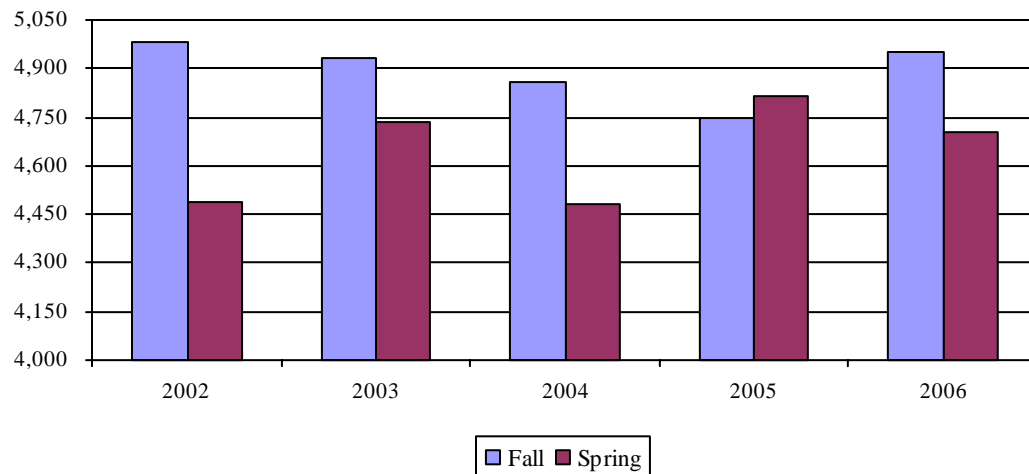


* Other includes:
FY 2004 - Gifts (2.23%), Other Operating Revenue (.25%), and Other Nonoperating Revenue (.25%)
FY 2005 - Gifts (2.58%), Other Operating Revenue (.14%), and Other Nonoperating Revenue (.07%)
** net of scholarship allowance
*** net of scholarship revenue

Under nonoperating revenues, state appropriations increased by \$2.2 million, a 6.9 percent increase from the previous year. Student tuition and fee revenue is shown net of tuition discounts and scholarship allowances. A tuition discount or scholarship allowance is the difference between the stated charge for goods and services provided by the University and the amount that is paid by students and/or third parties on their behalf. Gross student tuition and fees were \$21,382,396 and auxiliary enterprise revenue was \$23,510,246. The tuition discounts and scholarship allowances totaling \$11,243,961 is divided between tuition and fees (\$5,366,367) and auxiliary enterprises (\$5,877,594).

As demonstrated on the following chart, combined fall and spring enrollment is starting to recover from the dip in fiscal year 2004 (9,342), growing to a total enrollment in the year ended June 30, 2005 of 9,560 and projected to be 9,653 in fiscal year 2006. The fiscal year 2006 fall enrollment, just completed, was very strong, growing by 215 students from fiscal year 2005. Spring enrollment is normally lower than fall enrollment, although it was actually higher in fiscal year 2005. The fiscal year 2006 spring enrollment is a conservative estimate and could be lower than actual. These enrollment numbers indicate a continued interest in attending the University by students and their parents.

Student Enrollment
Fiscal Years 2002 - 2006



Summary of Expenses

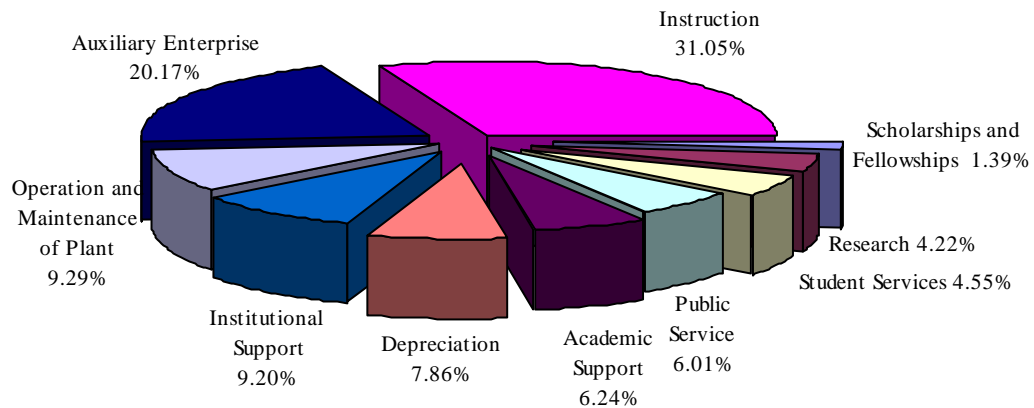
A summary of the University's expenses for the years ended June 30, 2004 and 2005 appears below. Total operating expenses increased by \$8.5 million in fiscal year 2005 compared to the previous fiscal year. This represents a 10.7 percent increase from the previous year. Instruction, which represents the largest component of operating expenses, increased by \$1.2 million (4.9 percent). Instruction represents 29.4 percent of total operating expenses in fiscal year 2005, compared to 31.1 percent in 2004. The second largest expenditure category, Auxiliary Enterprises, actually decreased slightly, going from \$16 million in fiscal year 2004 to \$15.4 million in 2005, a 3.5 percent decrease. Operation and maintenance of plant and depreciation both increased as new facilities came on line.

	<u>2005</u>	<u>2004</u>	<u>Increase/(Decrease)</u> <u>Amount</u>	<u>Percent</u>
Operating expenses:				
Instruction	\$25,931	\$24,718	\$1,213	4.9%
Research	2,849	3,361	(512)	(15.2%)
Public service	5,566	4,780	786	16.4%
Academic support	6,085	4,964	1,121	22.6%
Student services	3,700	3,620	80	2.2%
Institutional support	8,424	7,322	1,102	15.1%
Operation and maintenance of plant	11,337	7,398	3,939	53.2%
Scholarships and fellowships	1,326	1,106	220	19.9%
Auxiliary enterprises	15,476	16,045	(569)	(3.5%)
Depreciation	7,401	6,260	1,141	18.2%
Other operating expenses	-	23	(23)	(100.0%)
 Total operating expenses	 \$88,095	 \$79,597	 \$8,498	 10.7%

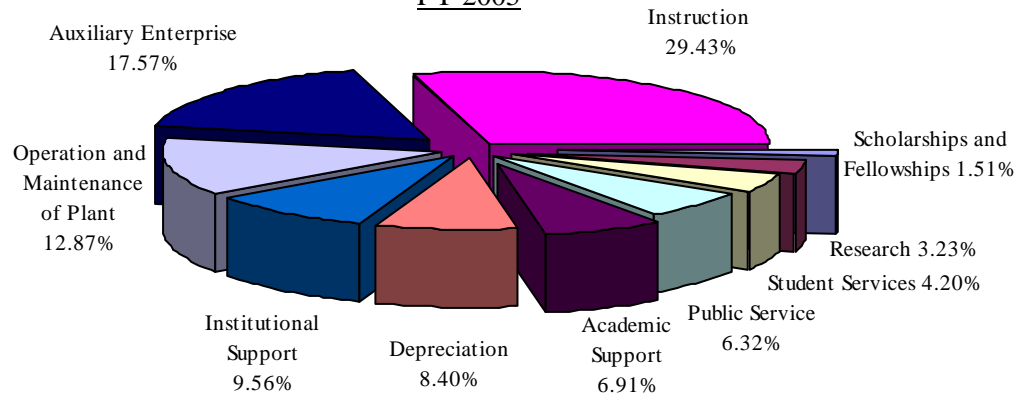
* in thousands

Summary of Expenses

FY 2004*



FY 2005



* does not include Other Operating Expenses (.03%)

Statement of Cash Flows

The Statement of Cash Flows provides additional information about the University's financial results by reporting the major sources and uses of cash. GASB principles define four major categories of cash flows: cash flows from operating activities, cash flows from noncapital financing activities, cash flows from capital and related financing activities, and cash flows from investing activities.

This statement provides a slightly different perspective from the Statement of Revenues, Expenses, and Changes in Net Assets. On the latter statement, state appropriations and gifts are considered nonoperating revenue. However, on the Statement of Cash Flows, these revenues are reflected under noncapital financing activities, while investment income is shown under investing activities. These cash flows are crucial to funding the operation of the University.

Statement of Cash Flows *

	<u>2005</u>	<u>2004</u>	<u>Increase/(Decrease)</u>	
			<u>Amount</u>	<u>Percent</u>
Cash flows from:				
Operating activities	\$(29,095)	\$(24,065)	\$ (5,030)	(20.9%)
Noncapital financing activities	37,151	33,059	4,092	12.4%
Capital and related financing activities	(5,593)	(13,137)	7,544	57.4%
Investing activities	<u>3,649</u>	<u>(416)</u>	<u>4,065</u>	977.2%
Net increase/(decrease) in cash and cash equivalents	6,112	(4,559)	10,671	234.1%
Cash and cash equivalents, beginning of year	<u>54,168</u>	<u>58,727</u>	<u>(4,559)</u>	(7.8%)
Cash and cash equivalents, end of year	<u>\$60,280</u>	<u>\$54,168</u>	<u>\$6,112</u>	11.3%

* in thousands

Overall, there was a \$6.1 million increase in cash in fiscal year 2005. This compared to a decrease of cash in the previous fiscal year of \$4.6 million. Although cash outflow from operating activities actually increased in fiscal year 2005, this was more than offset by cash inflows from noncapital financing activities, a reduction in outflows from capital and related financing activities, and inflows from investing activities. The loss outflows from capital financing activities was primarily the result of an increase in capital appropriations and a decrease in the purchase of capital assets from the levels of the previous fiscal year.

Capital and Debt Activities

The renewal and replacement of the University's capital assets is crucial to sustaining the quality of its academic and research programs and residential life. The University continues to invest in capital assets in accordance with its long range plan, modernizing its older facilities, balanced with new construction.

Capital assets, net of depreciation increased by \$1,710,531, going from \$74,551,734 to \$76,262,265, a 2.3 percent increase. Projects that were completed during fiscal year 2005 include the Johnston Memorial Library Renovation and dormitory upgrades and repairs.

Projects that were in progress at June 30, 2005, include:

New tennis court construction	Improvement to Handicap Access
Gymnasium seating renovation	(ADA upgrades to Admissions building)
Repair sanitary and storm sewer lines	Rogers Stadium Renovation (Phases I and II)
Gandy Hall renovation	Construction of Engineering and Technology Building

Proper management of University resources requires the prudent use of debt to finance capital projects. University bonds are issued pursuant to Section 9(c) of Article X of the Constitution of Virginia. Most of the bonds at the University are Section 9(c) bonds and are backed by the full faith, credit and taxing power of the Commonwealth.

Future Economic Outlook

The Executive Management of the University believes that the University is well positioned to maintain and strengthen its financial position, and to continue to provide excellent services and programs to its students and other constituents. The University's financial position continues to improve each year as evidenced by the accompanying financial statements.

A major factor in the University's overall financial health and future will continue to be its relationship with the Commonwealth of Virginia. There is a direct relationship between the amount of state support and the ability of the University to carry out its mission and to keep tuition and fees at a reasonable and affordable level. The University is pleased with the favorable increase in state appropriations and is hopeful that the Governor and General Assembly will continue to provide needed state support in the future.

State appropriations for the University, expressed as a percentage of total budgeted funds have fallen since 2004, a year in which the University's budget from General Fund appropriations was reduced by \$2 million. Even with this reduction, state appropriations made up 37.0 percent of the University's approved budget in 2004. Although there have been increases in state appropriations since 2004, they still have not returned to the pre-cut levels, falling to 34.9 percent of the budget in 2005 and projected to be 35.8 percent in 2006.

Reductions in state appropriations require the University to charge students and others more for services. This situation is exacerbated by the increase in fuel costs, which are projected to increase by approximately \$500,000 and continue to remain high. Increased fuel and energy costs will have an effect for the entire Commonwealth. We remain confident that the Commonwealth will continue to be a strong partner in helping the University face the future.

The University, under an agreement between the Commonwealth of Virginia and the U.S. Department of Education, Office for Civil Rights, receives funding for the elimination of the vestiges of segregation in higher education. The amount appropriated in fiscal year 2006 is \$2,880,862, an increase of \$90,460 (3.2 percent).

Looking to the Future

On February 21, 2005, the General Assembly passed legislation known as the Higher Education Restructuring Act. House Bill 2866 and companion Senate Bill 1327 proposes a system-wide approach to greater efficiencies, accountability, and autonomy for institutions of higher education in the Commonwealth. Key among the conditions institutions must meet is the development of a six-year financial, economic, and enrollment plan. The University has just completed the plan, which is designed to make the University more efficient and autonomous. The University looks forward to the challenge and opportunities this legislation brings to its campus.

State Appropriations

	<u>2004</u>	<u>2005</u>	<u>2006</u>
State appropriations:			
General Fund:			
University	\$27,637,351	\$29,723,681	\$31,257,407
Extension service	<u>2,895,475</u>	<u>3,390,285</u>	<u>4,143,322</u>
Total	<u>30,532,826</u>	<u>33,113,966</u>	<u>35,400,729</u>
Higher education operating:			
University	47,329,961	56,344,823	58,066,232
Extension service	<u>3,483,223</u>	<u>3,905,431</u>	<u>4,020,832</u>
Total	<u>50,813,184</u>	<u>60,250,254</u>	<u>62,087,064</u>
Debt service:			
University	<u>1,068,790</u>	<u>1,505,440</u>	<u>1,498,598</u>
Total	<u>\$82,414,800</u>	<u>\$94,869,660</u>	<u>\$98,986,391</u>
State appropriations:			
University	\$76,036,102	\$87,573,944	\$90,822,237
Extension service	<u>6,378,698</u>	<u>7,295,716</u>	<u>8,164,154</u>
Total	<u>\$82,414,800</u>	<u>\$94,869,660</u>	<u>\$98,986,391</u>
Percentage of total appropriations:			
General Fund	37.0%	34.9%	35.8%
Higher education	61.7%	63.5%	62.7%
Debt service	<u>1.3%</u>	<u>1.6%</u>	<u>1.5%</u>
Total	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

VIRGINIA STATE UNIVERSITY
STATEMENT OF NET ASSETS
As of June 30, 2005

	University	VSUF	VSUREF
ASSETS			
Current assets:			
Cash and cash equivalents (Note 2)	\$ 28,742,032	\$ 606,080	\$ 1,154,635
Short-term investments (Note 2)	885,150	4,873,236	133,335
Accounts and loans receivable, net of allowance for doubtful accounts (Note 3)	2,967,881	-	65,128
Due from the Commonwealth (Note 3)	791,724	-	-
Inventory	440,336	-	-
Due from affiliates	-	8,500	130,586
Prepaid expenses	2,158,569	-	140
Notes and mortgages receivable, net of allowance for doubtful accounts (Note 3)	54,609	120,152	-
Total current assets	36,040,301	5,607,968	1,483,824
Noncurrent assets:			
Restricted cash and cash equivalents (Note 2)	31,537,605	-	1,212,299
Restricted investments (Note 2)	251,045	-	-
Endowment investments (Note 2)	8,757,225	-	-
Notes and mortgages receivable, net of allowance for doubtful accounts (Note 3)	2,367,406	-	-
Other long-term investments (Note 2)	1,046,095	-	-
Unamortized issuance cost	22,702	-	608,914
Gain on advance refunding	979	-	-
Nondepreciable capital assets (Note 4)	30,076,576	-	542,828
Depreciable capital assets, net (Note 4)	46,185,690	-	14,384,390
Total noncurrent assets	120,245,323	-	16,748,431
Total assets	156,285,624	5,607,968	18,232,255
LIABILITIES			
Current liabilities:			
Accounts payable and accrued liabilities (Note 5)	5,603,533	47,937	256,309
Due to affiliates	-	1,658	120,152
Deferred revenue	2,954,443	-	-
Retainage payable	452,145	-	-
Obligations under securities lending (Note 2)	5,050,684	-	-
Deposits held in custody for others	1,626,622	-	128,360
Long-term liabilities - current portion (Notes 6 and 7)	2,267,850	-	-
Other current liabilities	57,177	-	998,477
Total current liabilities	18,012,454	49,595	1,503,298
Noncurrent liabilities:			
Long-term liabilities - noncurrent (Notes 6 and 7)	14,566,281	-	18,439,279
Other noncurrent liabilities (Note 6)	1,453,900	-	2,149,391
Deferred revenue	-	-	47,381
Total noncurrent liabilities	16,020,181	-	20,636,051
Total liabilities	34,032,635	49,595	22,139,349

VIRGINIA STATE UNIVERSITY
STATEMENT OF NET ASSETS
As of June 30, 2005

	University	VSUF	VSUREF
NET ASSETS			
Invested in capital assets, net of related debt	65,768,777	-	257,253
Restricted for:			
Nonexpendable:			
Scholarships and fellowships	1,254,197	-	-
Instructional	488,392	-	-
Other	187,254	3,155,743	-
Expendable:			
Scholarships and fellowships	6,800,789	-	-
Instruction	206,072	-	-
Loans	745,132	-	-
Capital projects	29,003,144	-	-
Other	225,495	748,832	-
Unrestricted	17,573,737	1,653,798	(4,164,347)
Total net assets	\$ 122,252,989	\$ 5,558,373	\$ (3,907,094)

The accompanying Notes to Financial Statements are an integral part of this statement.

VIRGINIA STATE UNIVERSITY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
For the Year Ended June 30, 2005

	University	VSUF	VSUREF
Operating revenues:			
Student tuition and fees, net of scholarship allowances of \$5,366,367	\$ 16,016,029	\$ -	\$ -
Federal grants and contracts	18,996,871	-	-
State and local grants and contracts	221,036	-	-
Sales and services - educational departments	65,317	-	-
Sales and service - auxiliary enterprises, net of scholarship allowances of \$5,877,594 (Note 9)	17,632,652	-	-
Other operating revenues	74,863	-	2,316,318
Total operating revenues	53,006,768	-	2,316,318
Operating expenses: (Note 10)			
Education and general:			
Instruction	25,931,370	-	-
Research	2,849,401	6,476	-
Public service	5,565,747	-	-
Academic support	6,084,821	-	-
Student services	3,700,309	-	-
Institutional support	8,424,308	370,736	891,062
Operation and maintenance of plant	11,336,472	-	-
Scholarships and fellowships	1,325,551	221,628	-
Auxiliary enterprises (Note 9)	15,475,753	-	-
Depreciation	7,401,366	-	768,788
Total operating expenses	88,095,098	598,840	1,659,850
Operating income/(loss)	(35,088,330)	(598,840)	656,468
Nonoperating revenues/(expenses):			
State appropriations (Note 8)	34,081,092	-	-
Gifts	1,627,628	238,041	-
Investment income	452,174	373,418	23,245
Interest on capital asset-related debt	(704,677)	-	-
Interest on indebtedness	34,330	-	(1,826,169)
Loss on disposal of assets	(3,003)	-	-
Other nonoperating revenues	496,069	-	56,225
Other nonoperating expenses	(211,598)	(31,433)	-
Net nonoperating revenue (expense)	35,772,015	580,026	(1,746,699)
Income before other revenues, expenses, gains, and losses	683,685	(18,814)	(1,090,231)
Capital appropriations (Note 8)	7,107,000	-	-
Capital grants and gifts	568,399	-	-
Additions to permanent endowments	303,377	356,373	-
Total other revenues	7,978,776	356,373	-
Increase/(Decrease) in net assets	8,662,461	337,559	(1,090,231)
Net assets, beginning of year, as restated (Note 1N)	113,590,528	5,220,814	(2,816,863)
Net assets, end of year	\$ 122,252,989	\$5,558,373	\$(3,907,094)

The accompanying Notes to Financial Statements are an integral part of this statement.

VIRGINIA STATE UNIVERSITY
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2005

Cash flows from operating activities:

Tuition and fees	\$ 15,940,620
Grants and contracts	18,889,405
Auxiliary enterprises	17,566,584
Other revenues	91,472
Payments to employees	(42,654,781)
Payments to suppliers	(30,433,816)
Payments for utilities	(5,598,232)
Payments for scholarships and fellowships	(3,016,017)
Loans issued to students	(396,955)
Collection of loans from students	429,553
Other payments	87,287

Net cash used by operating activities (29,094,880)

Cash flows from noncapital financing activities:

State appropriations	34,081,092
Gifts	1,931,004
Other nonoperating revenue	284,471
Loss on disposal of assets	(3,003)
Funds held in custody for others - receipts	8,249,568
Funds held in custody for others - disbursements	(7,891,066)
Federal direct lending program receipts	21,028,357
Federal direct lending program disbursements	(20,528,994)

Net cash provided by noncapital financing activities 37,151,429

Cash flows from capital financing activities:

Capital appropriations	7,107,000
Capital gifts and grants	568,399
Interest paid on capital debt, leases, and installments	(676,395)
Principal paid on capital debt, leases, and installments	(1,130,993)
Principal received on capital debt, leases, and installments	13,347
Purchase of capital assets	(11,474,826)

Net cash used by capital financing activities (5,593,468)

Cash flows from investing activities:

Investment income	452,171
Proceeds from sales and maturities of investments	4,240,861
Purchase of investments	(1,044,084)

Net cash used by investing activities 3,648,948

Net increase in cash 6,112,029

Cash and cash equivalents - beginning of the year 54,167,608

Cash and cash equivalents - end of the year \$ 60,279,637

VIRGINIA STATE UNIVERSITY
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2005

RECONCILIATION OF NET OPERATING LOSS TO NET CASH
USED BY OPERATING ACTIVITIES:

Operating loss	(35,088,330)
Adjustments to reconcile net cash used by operating activities:	
Depreciation expense	7,401,366
Changes in assets and liabilities:	
Receivables	(880,156)
Inventories	(6,425)
Prepaid items	(583,165)
Other assets	23,460
Accounts payable	(425,573)
Interest payable	6,050
Deferred revenue	394,066
Other liabilities	<u>63,827</u>
Net cash used by operating activities	<u><u>\$ (29,094,880)</u></u>

Noncash investing, capital, and financing activities:

Loss on disposal of assets	<u><u>\$ (3,003)</u></u>
Change in fair value of investments recognized as a component of income	<u><u>\$ (346,097)</u></u>
Principal and interest on capital debt paid by state agency on behalf of the University	<u><u>\$ 830,325</u></u>

The accompanying Notes to Financial Statements are an integral part of this statement.

VIRGINIA STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS

AS OF JUNE 30, 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

Virginia State University (University), founded in 1882, is one of two land grant universities in the state, having been so designated in 1920. As a land grant institution, the University engages in natural resources-related research projects and agricultural extension services. The institution attained university status in 1979. The University offers programs at the doctoral, graduate, and undergraduate levels in science, education, humanities, social sciences, and business. The University's stated mission is to prepare students to advance intellectually, socially, economically, and politically, so they and the University will make significant contributions to the enhancement of society.

The University is a component unit of the Commonwealth of Virginia and is included in the Comprehensive Annual Financial Report (CAFR) of the Commonwealth. These basic financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB) applicable to colleges and universities. They are prepared for and at the direction of the Commonwealth of Virginia for inclusion in the Commonwealth's CAFR, which includes all agencies, boards, commissions, and authorities associated with the University over which the Commonwealth exercises or has the ability to exercise oversight authority.

Effective with fiscal year 2005, the University was required to implement GASB Statement 40, *Deposit and Investment Risk Disclosures*. This statement addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest rate risk, this statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Deposit and investment policies related to the risks identified in this statement must be disclosed. GASB Statement 40 also modifies disclosures required by GASB Statement 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*. Portions of that Statement have been eliminated or modified.

Under GASB Statement 39 standards, the Virginia State University Foundation (VSUF) and the Virginia State University Real Estate Foundation (VSUREF) meet criteria qualifying them as component units of the University.

The VSUF is a legally separate component unit of the University and was organized as a tax-exempt charitable and educational organization in 1968. The purpose of this foundation is to accept contributions from individual donors and to safeguard, invest, and distribute the funds as designated by the donors or the Board of Trustees for the benefit of the University, its students, alumni, and educational community in support of the University's mission.

The VSUREF is a legally separate component unit of the University and was organized as a tax-exempt charitable and educational organization in 2002. Operations began in August 2003. The purpose of the Foundation is to construct and manage the University Apartments at Ettrick, a 504-bedroom facility for the University, in support of the University's mission.

Although the University does not control the timing or amount of receipts from either the VSUF or the VSUREF, the majority of the resources or income thereof that both foundations hold and invest is restricted to the activities of the University by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the University, the VSUF and the VSUREF are considered component units of the University and are discretely presented in the University's financial statements.

During the year ended June 30, 2005, the VSUF distributed \$246,448 to the University for both restricted and unrestricted purposes. Separate financial statements for the VSUF can be obtained by writing Virginia State University Foundation c/o Larry Saunders & Associates, CPAs, 2902 Chamberlayne Avenue, Richmond, VA 23222. Separate financial statements for the VSUREF can be obtained by writing Virginia State University Real Estate Foundation c/o Vice President of Development, Storum Hall, P.O. Box 9027, Petersburg, VA 23806.

B. Basis of Presentation

The University's accounting policies conform with generally accepted accounting principles as prescribed by GASB, including all applicable GASB pronouncements, as well as applicable Financial Accounting Standards Board (FASB) statements and interpretations, Accounting Principles Board opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The financial statements have been prepared in accordance with GASB Statement 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, and GASB Statement 35, *Basic Financial Statements and Management's Discussion and Analysis of Public Colleges and Universities*.

The VSUF and the VSUREF are private, nonprofit organizations that report under FASB standards, including FASB Statement 117, *Financial Reporting for Not-for-Profit Organizations*. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition and presentation features. No modifications have been made to the foundations' information in the University's financial reporting entity for these differences.

C. Basis of Accounting

The University's financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned and expenses are recorded when a liability has been incurred, regardless of the timing of related cash flows. All significant intra-agency transactions have been eliminated.

D. Cash Equivalents

The University considers all highly liquid investments with an original maturity of 90 days or less to be cash equivalents. Funds invested through the State Non-Arbitrage Program (SNAP) and portions of the funds invested in the State Securities Lending Program are considered cash equivalents.

E. Investments

In accordance with GASB Statement 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, investments are recorded at fair market value at June 30, 2005. All investment income, including changes in the fair value of investments (unrealized gains and losses), is reported as nonoperating revenue in the Statement of Revenues, Expenses, and Changes in Net Assets.

F. Inventory

Inventory is valued at the lower of cost or market. The inventory held by the University consists of supplies held for consumption.

G. Capital Assets

Capital assets consisting of land, buildings, equipment, infrastructure assets, improvements other than buildings, inexhaustible works of art, and construction-in-progress are stated at appraised historical cost or actual cost, where determinable. Purchased or constructed capital assets are reported at cost. Donated capital assets are reported at fair value on the date of acquisition. Library books are valued at replacement cost as determined by the State Council of Higher Education. Equipment is capitalized when the acquisition cost is \$5,000 or greater and the estimated useful life is one year or more. Expenses for construction-in-progress are capitalized as incurred. Infrastructure assets are recorded at cost. Depreciation is calculated using the straight-line method over the estimated useful life as follows:

Buildings	40-50 years
Infrastructure assets	15-20 years
Equipment	7-10 years
Library books	5 years
Other improvements	20 years

H. Restricted and Unrestricted Net Assets

Resources restricted by outside sources are distinguished from unrestricted resources allocated for specific purposes by action of the Board of Visitors. Externally-restricted resources may be utilized only in accordance with the purposes established by the source of such resources and are in contrast with unrestricted resources, of which the governing board retains full control to use in achieving the institutional purpose.

Restricted net assets can be expendable or nonexpendable. Nonexpendable restricted net assets are endowments and similar type funds where the donor(s) or some other outside source has stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and

future income, which may either be expended or added to principal. Expendable restricted net assets are resources, which the University is legally or contractually obligated to spend in accordance with the restrictions imposed by external parties.

Unrestricted net assets are resources derived primarily from state appropriations, sales and services of educational departments, student tuition and fees, auxiliary enterprises fees and revenues, and gifts. Auxiliary enterprises are self-supporting activities that provide services for students, faculty, and staff. These unrestricted resources are used for transactions relating to the educational and general operations of the University and at the discretion of the governing board to meet current expenses.

When an expense has been incurred that can be paid using either restricted or unrestricted resources, the University's policy is first to apply the expense toward restricted resources and then toward unrestricted. Restricted funds remain classified as such until restrictions have been satisfied.

I. Deferred Revenue

Deferred revenue represents monies received, but not earned as of June 30, 2005. Amounts for student tuition and fees received in advance of the academic term and revenues received from grant and contract sponsors, but not spent or earned are considered as deferred revenue.

J. Accrued Compensated Absences

The amount of leave earned, but not taken by 12-month faculty and salaried employees is recorded as a liability on the Statement of Net Assets. The amount reflects all unused vacation leave, overtime leave, compensatory leave, and the amount payable upon termination under the Commonwealth of Virginia's sick leave payout policy as of June 30, 2005. The applicable share of employer-related taxes payable on eventual termination payments is also included.

K. Revenue and Expense Classifications

Operating revenues include activities that have the characteristics of exchange transactions, such as: (1) student tuition and fees, net of scholarship discounts and allowances; (2) federal, state, and nongovernmental grants and contracts; and (3) sales and services of auxiliary enterprises, net of scholarships allowances.

Non-operating revenues include activities that have the characteristics of nonexchange transactions such as gifts and other revenue sources that are defined as nonoperating revenues by GASB Statement 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*, and GASB Statement 34, such as state appropriations and investment and interest income.

Non-operating expenses include interest on debt related to the purchase of capital assets and investment expenses. All other expenses are classified as operating expenses.

L. Scholarship Discounts and Allowances

Scholarship allowances are the difference between the stated charge for goods and services provided by the University and the amount that is paid by the students and/or third parties on their behalf. Student tuition and fee revenues, and certain other revenues from students, are reported net of scholarship allowances. To the extent that revenues from certain governmental and nongovernmental grants and programs reported as either operating or nonoperating revenues in the financial statements are used to satisfy tuition and fees and other student charges, such as room and board and comprehensive fees, these revenues have been defined as scholarship allowances and allocated to reduce student tuition and fees. This eliminates the historical practice of double counting restricted revenues received and used to pay for tuition and fees.

M. Federal Financial Assistance Programs

The University participates in federally-funded programs such as Pell Grants, Supplemental Educational Opportunity Grants, Federal Work-Study, and the Perkins Loan programs. Federal programs are audited in accordance with the Single Audit Act Amendments of 1996, the Office of Management and Budget Revised Circular A-133, *Audit of States, Local Governments and Non-Profit Organizations, and the Compliance Supplement*.

N. Restatement of Beginning Net Assets

The beginning net assets of the University have been restated to \$113,590,528 as of June 30, 2004. The University's balance for Accumulated Depreciation for Buildings was adjusted in the amount of \$1,161,635. This adjustment was related to costs associated with Langston Hall which had never been moved from Construction-in-progress (nondepreciable asset) to Buildings (depreciable asset) in the University's accounting records. Certain costs related to Langston Hall should have been reclassified from Construction-in-progress to Buildings in the amount of \$315,286 in 1999 when the Certificate of Occupancy was issued. As a result, these costs were never depreciated. An additional adjustment was made to recognize the current depreciation.

In addition, an adjustment was made to write down Buildings in the amount of \$657,807 related to dormitory refurbishment funds sponsored by two state legislators (Bagley-Willey) in the early 1990's. Items purchased with these funds are fully depreciated. There was an additional adjustment to Equipment related to the handling of the Equipment Trust Fund (ETF) in the amount of \$299,307. A prior period adjustment was made for the ETF in fiscal year 2003 and additional adjustments were needed in subsequent fiscal years. However, the adjustment was inadvertently not made in 2004. Lastly, several other minor adjustments were made to write down Equipment in the amount of \$164,946. These adjustments were related to items carried on the reconciliation from prior years that should have been removed.

Restatement of Beginning Net Assets

Net assets as of June 30, 2004	\$115,874,223
Restatement of:	
Buildings	(342,521)
Construction-in-progress	(315,286)
Equipment	(164,946)
Accumulated depreciation:	
Buildings	(1,161,635)
Equipment	<u>(299,307)</u>
Restated net assets as of July 1, 2004	<u>\$113,590,528</u>

2. CASH AND CASH EQUIVALENTS AND INVESTMENTS

A. Cash and Cash Equivalents

Pursuant to Section 2.2-1800, et seq., Code of Virginia (1950) as amended, all state funds of the University are held by the Treasurer of Virginia, who is responsible for the collection, disbursement, custody, and investment of state funds. Cash deposits held by the University are maintained in accounts that are covered by federal depository insurance or collateralized in accordance with the Virginia Security for Public Deposits Act, Section 2.2-4400 of the Code of Virginia. In accordance with the GASB Statement 9 definition of cash and cash equivalents, cash represents cash with the Treasurer of Virginia, cash on hand, and cash deposits including certificates of deposit and temporary investments with original maturities of three months or less. At June 30, 2005, the carrying amount of cash and cash equivalents was \$60,279,637.

B. Investments - Credit Risk, Custodial Credit Risk, and Interest Rate Risk

Effective with fiscal year 2005, the University was required to implement GASB Statement 40, *Deposit and Investment Risk Disclosures*. This statement addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest rate risk, this statement requires certain disclosures of investments with fair values that are highly sensitive to changes in interest rates. Deposit and investment policies related to the risks identified in this statement must be disclosed. GASB Statement 40 also modifies disclosures required by GASB Statement 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*.

As of June 30, 2005, the University had the following investments and maturities:

<u>Investment Type</u>	<u>Fair Value</u>	<u><1 Year</u>	<u>1-5 Years</u>	<u>6-10 Years</u>
U.S. Treasury and agency	\$ 1,945,313	\$283,861	\$1,584,659	\$ 76,793
Corporate and other bonds	1,020,924	-	687,740	333,184
Corporate stock	6,906,421	-	-	-
Money market funds	<u>168,879</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total	<u>10,041,537</u>	<u>283,861</u>	<u>2,272,399</u>	<u>409,977</u>
Securities lending	<u>5,050,684</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total investments	<u>\$15,092,221</u>	<u>\$283,861</u>	<u>\$2,272,399</u>	<u>\$409,977</u>

The following information is provided with respect to the credit risk associated with the University's cash and cash equivalents and investments at June 30, 2005.

C. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair market value of an investment. The University's policy for investment of endowment fund assets requires that the investments be allocated as follows:

Allocation of investments:	
U.S. large cap stocks	45-55%
U.S. small cap stocks	0-15%
International stocks	0-15%
Fixed income	20-40%
Cash and short-term investments	0-30%

This asset allocation helps reduce the University's exposure to interest rate risk.

D. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. Statutes authorize the investment of local funds held by the University in obligations of the Commonwealth; federal government; other states or political subdivisions thereof; Virginia political subdivisions; the International Bank for Reconstruction and Development; the Asian Development Bank; and the African Development Bank. In addition, the University may invest in prime quality commercial paper rated Prime 1 by Moody's Investment Service or A-1 by Standard and Poor's, Incorporated. The University may also invest in overnight term or open repurchase agreements and money market funds.

E. Custodial Credit Risk

Custodial credit risk for investments is the risk that in the event of the failure of the counterparty, the endowment funds will not be able to recover the value of the investments that are in possession of an outside party. The University does not have a formal investment policy for custodial arrangements. At June 30, 2005, the University endowment funds were held at the custodial banks, Citibank and Wachovia.

F. Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government or university in a single issuer. The University does not have a formal policy to reduce concentration of credit risk; however, all of the University's investments were held in various instruments and stocks and were not exposed to this risk.

<u>Credit Rating</u>	<u>Corporate Bonds</u>	<u>Treasury Securities</u>	<u>Corporate Stock</u>	<u>Money Market Funds</u>
A+	\$ 379,347	\$ -	\$ -	\$ -
AA -	248,087	-	-	-
A -	71,388	-	-	-
A	64,914	-	-	-
AA	144,090	-	-	-
BBB +	56,737	-	-	-
BBB -	56,361	-	-	-
Not rated	<u>-</u>	<u>1,945,313</u>	<u>6,906,421</u>	<u>168,879</u>
Total	<u>\$1,020,924</u>	<u>\$1,945,313</u>	<u>\$6,906,421</u>	<u>\$168,879</u>

G. VSUF - Cash and Investments

The investments of the VSUF consist primarily of equity securities and mutual funds. All investments are stated at fair value as reported by investment managers and reflect readily determinable market prices. All investments are considered available for sale. Realized gains are calculated based on the difference between the cost and selling price of the security. The amount of investments held by the Foundation at June 30, 2005, was \$4,873,236.

H. VSUREF - Cash and Investments

The investments of the VSUREF consist primarily of U.S. government money market funds. All investments are stated at fair value as reported by investment managers and reflect readily determinable market prices. All investments are considered available for sale. Realized gains are calculated based on the difference between the cost and selling price of the security. Cost is determined based on the initial purchase price of each individual investment. The amount of investments held by the Foundation at June 30, 2005, was \$133,335.

I. Securities Lending Transactions

Investments held by the Treasurer of Virginia include the University's allocated share of securities totaling \$5,050,684 received for securities lending transactions and held in the General Account of the Commonwealth. Information related to the credit risk of these investments and securities lending transactions held in the General Account is available on a statewide level in the Commonwealth of Virginia's CAFR.

3. ACCOUNTS RECEIVABLE AND NOTES RECEIVABLE

A. Accounts Receivable

Accounts receivable is shown net of allowance for doubtful accounts in the accompanying Statement of Net Assets.

At June 30, 2005, accounts receivable consisted of the following:

Student tuition and fees	\$ 640,267
Federal, state, and private grants and contracts	2,172,335
Auxiliary enterprises	60,073
Pledges	124,263
Other receivables	65,928
Due from VSUREF	103,847
Due from VSUF	<u>73,864</u>
Total	<u>3,240,577</u>
Less: Allowance for doubtful accounts	<u>(272,696)</u>
Net accounts receivable	<u>\$2,967,881</u>

Pledges receivable represent pledges of financial support from corporations, foundations, and individuals. Pledges are recorded as gifts and certain pledges are recorded at present value using a discount rate of five percent. Allowance for doubtful accounts includes an allowance on pledges receivable amounting to \$24,853.

B. Due from the Commonwealth

Receivables due from the Commonwealth represent reimbursement receivables for equipment purchases made by the University under the Equipment Trust Fund Program. On a reimbursement basis, this program provides state-supported institutions of higher education with bond proceeds for financing the acquisition and replacement of instructional and research equipment. Due from the Commonwealth shown on the Statement of Net Assets at June 30, 2005, is \$791,724.

C. Notes Receivable

Notes receivable are shown net of allowance for doubtful accounts in the accompanying Statement of Net Assets.

At June 30, 2005, notes receivable consisted of the following:

<u>Notes receivable</u>	
Federal student loans	\$1,696,782
Other loans	20,689
JPI Apartment Development, LLP	25,000
VSUREF	<u>837,956</u>
Total	<u>2,580,427</u>
Less: Allowance for doubtful accounts	<u>(158,412)</u>
Total notes receivable	<u>\$2,422,015</u>

Total net receivables as of June 30, 2005 were \$5,389,896. Net receivables not expected to be collected within one year is \$1,483,761 for federal student loans; \$20,689 for other loans; \$25,000 for JPI; and \$837,956 for VSUREF.

4. CAPITAL ASSETS

The beginning balance for Construction-in-Progress has been decreased by \$315,286 due to the restatement discussed in Note 1. The beginning balance for Buildings has been decreased by \$342,521 due to the restatement discussed in Note 1. The beginning balance for Equipment decreased by \$164,946 due to the prior period adjustment discussed in Note 1. The beginning balance for Accumulated Depreciation - Buildings has been increased by \$1,161,635 due to the prior period adjustment discussed in Note 1. The beginning balance for Accumulated Depreciation - Equipment has been increased by \$299,307 due to the adjustment discussed in Note 1. A summary of changes in the various capital asset categories for the year ending June 30, 2005, is presented as follows:

	<u>Beginning Balances</u>	<u>Increase</u>	<u>Decrease</u>	<u>Ending Balance</u>
Nondepreciable capital assets:				
Land	\$ 267,084	\$ -	\$ -	\$ 267,084
Inexhaustible works of art and/or historical treasures	354,645	-	-	354,645
Construction-in-progress	<u>24,812,701</u>	<u>7,045,666</u>	<u>(2,403,520)</u>	<u>29,454,847</u>
Total nondepreciable capital assets	<u>25,434,430</u>	<u>7,045,666</u>	<u>(2,403,520)</u>	<u>30,076,576</u>
Depreciable capital assets:				
Buildings	93,697,756	2,744,549	-	96,442,305
Equipment	21,878,055	2,735,973	(776,454)	23,837,574
Infrastructure assets	8,622,538	163,614	-	8,786,152
Improvements other than buildings	3,856,641	73,180	-	3,929,821
Library books	<u>16,130,645</u>	<u>1,036,129</u>	<u>-</u>	<u>17,166,774</u>
Total depreciable capital assets	<u>144,185,635</u>	<u>6,753,445</u>	<u>(776,454)</u>	<u>150,162,626</u>

Less accumulated depreciation for:

Buildings	61,546,779	4,094,156	-	65,640,935
Equipment	15,098,429	1,810,795	(776,454)	16,132,770
Infrastructure assets	5,859,911	389,857	-	6,249,768
Improvements other than buildings	1,342,444	226,799	-	1,569,243
Library books	<u>13,504,461</u>	<u>879,759</u>	<u>-</u>	<u>14,384,220</u>
Total accumulated depreciation	97,352,024	7,401,366	(776,454)	103,976,936
Depreciable capital assets, Net	<u>46,833,611</u>	<u>(647,921)</u>	<u>-</u>	<u>46,185,690</u>
Total capital assets, Net	<u>\$ 72,268,041</u>	<u>\$6,397,745</u>	<u>\$(2,403,520)</u>	<u>\$ 76,262,266</u>

Net capital assets of the VSUREF consist of \$542,828 for Land and \$14,384,390 (net of accumulated depreciation of \$887,383) for Buildings, Land Improvements, and Equipment for the year ending June 30, 2005.

5. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consist of the following at June 30, 2005:

Accounts payable and accrued liabilities:	
Employee salaries, wages, and fringe benefits payable	\$3,569,511
Matured interest payable	130,754
Vendor and supplies accounts payable	<u>1,903,268</u>
Total accounts payable and accrued liabilities	<u>\$5,603,533</u>

6. LONG-TERM LIABILITIES

The University's non-current liabilities consist of long-term debt (further described in Note 7) and other non-current liabilities. A summary of changes in non-current liabilities for the year ending June 30, 2005, is presented as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Current Portion</u>	<u>Noncurrent</u>
Long-term debt:						
General obligation revenue bonds	\$ 6,335,995	\$ 5,180	\$ (744,181)	\$ 5,596,994	\$ 735,000	\$ 4,861,994
Notes payable	8,586,875	8,167	(324,859)	8,270,183	307,949	7,962,234
Installment purchases	<u>176,649</u>	<u>-</u>	<u>(61,953)</u>	<u>114,696</u>	<u>19,960</u>	<u>94,736</u>
Total long-term debt	<u>15,099,519</u>	<u>13,347</u>	<u>(1,130,993)</u>	<u>13,981,873</u>	<u>1,062,909</u>	<u>12,918,964</u>
Accrued compensated absences	2,719,638	1,555,052	(1,422,432)	2,852,258	1,204,941	1,647,317
Federal Perkins Loan contributions	<u>1,497,528</u>	<u>-</u>	<u>(43,628)</u>	<u>1,453,900</u>	<u>-</u>	<u>1,453,900</u>
Total long-term liabilities	<u>\$19,316,685</u>	<u>\$1,568,399</u>	<u>\$(2,597,053)</u>	<u>\$18,288,031</u>	<u>\$2,267,850</u>	<u>\$16,020,181</u>

7. LONG-TERM INDEBTEDNESS

A. Bonds Payable

The University's bonds are issued pursuant to Section 9 of Article X of the Constitution of Virginia. Most of the bonds at the university are section 9(c) bonds. These bonds are backed by the full faith, credit and taxing power of the Commonwealth, and are issued to finance capital projects which, when completed, will generate revenue to repay debt.

The University had a total of \$5,596,994 in bonds outstanding at June 30, 2005, consisting of the following:

	<u>Interest Rate</u>	<u>Maturity</u>	<u>Total</u>
Bonds payable:			
General obligation revenue bonds:			
Langston Hall Project, Series 1995	4% - 5%	2010	\$ 400,000
Langston Hall Project, Series 2002R	4% - 5%	2010	660,832
Foster Hall Project, Series 1995	4% - 5%	2010	360,000
Foster Hall Project, Series 2002R	4% - 5%	2010	592,102
Dorm Renovation Project, Series 1995	4% - 5%	2010	420,000
Dorm Renovation Project, Series 2002R	4% - 5%	2010	690,169
Jones Dining Hall Project, Series 1996	4% - 5%	2016	370,000
Jones Dining Hall Project, Series 1998	4% - 5%	2018	140,000
Jones Dining Hall Project, Series 2002R	4% - 5%	2016	1,357,553
Jones Dining Hall Project, Series 2004R	4% - 5%	2018	<u>606,338</u>
Total bond payables			<u>\$5,596,994</u>

Aggregate annual maturities of bonds payable for fiscal years after 2005 are:

<u>Maturity</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$ 735,000	\$ 266,143	\$1,001,143
2007	780,682	230,174	1,010,856
2008	772,842	191,926	964,768
2009	852,694	154,666	1,007,360
2010	891,522	120,102	1,011,624
2011 - 2016	1,152,428	274,444	1,426,872
2017 - 2018	<u>411,826</u>	<u>20,841</u>	<u>432,667</u>
Total	<u>\$5,596,994</u>	<u>\$1,258,296</u>	<u>\$6,855,290</u>

B. Prior Year Defeasance of Debt

In prior years, the Commonwealth of Virginia, on behalf of the University issued general obligation bonds. Proceeds were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the refunded bonds. As a result, the bonds refunded are considered defeased and not reflected in the University's financial statements. At June 30, 2005, \$3.3 million of bonds that were considered defeased were still outstanding.

C. Notes Payable

The University entered into a loan agreement with the Department of Housing and Urban Development (HUD) in 1989 and closed the agreement in 1992 to borrow funds to repair seven dormitories. The loan is to be repaid over 30 years at three percent interest and is secured by a lien on the net revenues from the ownership, operation, and use of the seven dormitories under repair. In prior years and in fiscal year 2004, the University participated in the Virginia College Building Authority (VCBA) Pooled Bond Program to fund the renovation of Rogers Stadium. As a participating institution in this program, the University issued a note payable to VCBA. This note, along with the notes of other institutions, is held by the VCBA as security for the Educational Facilities Revenue Bonds. At June 30, 2005, the outstanding balances were \$2,324,258 for the HUD loan and \$5,945,925 for the VCBA notes payable.

A summary of future principal and interest requirements of the HUD loan and VCBA notes payable as of June 30, 2005, are as follows:

<u>Maturity</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$ 307,949	\$ 355,287	\$ 663,236
2007	321,212	342,274	663,486
2008	334,573	328,163	662,736
2009	348,036	313,450	661,486
2010	366,604	298,007	664,611
2011 – 2015	2,070,424	1,231,886	3,302,310
2016 – 2020	2,582,252	708,514	3,290,766
2021 - 2023	1,643,208	117,406	1,760,614
Add: Unamortized Premium	<u>295,925</u>	<u>-</u>	<u>295,925</u>
Total	<u>\$8,270,183</u>	<u>\$3,694,987</u>	<u>\$11,965,170</u>

D. Installment Purchases

In November 2003, the University entered into a seven-year lease purchase agreement with Koch Financial Corporation to provide financing of buses. The interest rate for this financing is 3.39 percent. As of June 30, 2005, the total installment lease obligation related to this agreement was \$114,696.

Principal and interest payments on these commitments for fiscal years subsequent to June 30, 2005, are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$ 19,960	\$ 3,575	\$ 23,535
2007	20,646	2,890	23,536
2008	21,357	2,179	23,536
2009	22,091	1,445	23,536
2010	22,851	685	23,536
2011	<u>7,791</u>	<u>55</u>	<u>7,846</u>
Total	<u>\$114,696</u>	<u>\$10,829</u>	<u>\$125,525</u>

E. Foundation Debt

The VSUREF has an unsecured line of credit in the amount of \$1 million with an interest rate of LIBOR plus two percent, (5.34 percent at June 30, 2005) that expires on February 28, 2006. The VSUF guarantees the credit line.

To fund construction of the University Apartments at Ettrick, the VSUREF received proceeds from IDA Bonds issued by Chesterfield County. The bonds consist of a Series 2002A series for \$17,710,000 and a Series 2002B series for \$480,000. The bonds were issued on November 19, 2002, and amended September 1, 2004. The bonds are collateralized by the rental property and equipment. Also, the VSUREF is required to maintain a debt service reserve. The contractual interest rates are variable (1.07 percent for Series 2002A and 1.25 percent for Series 2002B at June 30, 2005). The 2002A series matures on July 1, 2029, and the 2002B series matures on July 1, 2006. The VSUREF has agreed to prepayment terms of the principal to the Trustee with payments due on July 1 as follows:

Payments Due	
<u>July 1,</u>	<u>Principal</u>
2006	\$ 215,000
2007	265,000
2008	300,000
2009	340,000
2010	395,000
thereafter	<u>16,675,000</u>
Total	<u>\$18,190,000</u>

The VSUREF has entered into an interest rate swap agreement as part of the provisions of the bond agreement. Per the terms of the swap agreement, the VSUREF pays a fixed rate of interest of 3.905 percent. The interest rate swap agreements qualify as derivative financial instruments and are used to mitigate the effect of interest rate fluctuations. The Foundation accounts for the interest rate swaps as fair value hedges whereby the fair value of these contracts is reflected in other liabilities in the accompanying statement of financial position with the offsets recorded as expenses. The fair value of these contracts was a negative \$1,534,391 at June 30, 2005. This is the amount the Foundation would have to pay to settle the interest rate swaps as of these respective dates.

In conjunction with the bond issuance, the University signed a support agreement with the VSUREF stating that the University Apartments at Ettrick Project will be an equal part of the Student Housing Program, the University will provide preferential treatment to assign 95 percent occupancy if the debt service coverage ratio is less than 1.2 to 1, and the University will limit additional housing projects.

8. STATE APPROPRIATIONS

The University receives state appropriations from the General Fund of the Commonwealth. The Appropriations Act specifies that such unexpended appropriations shall revert, as specifically provided by the General Assembly, at the end of a biennium.

The following is a summary of state appropriations received by the University for the year ended June 30, 2005:

Operating appropriations:

Virginia State University:

Education and general programs	\$24,214,554
Higher education student financial assistance	2,868,327
Financial assistance for education and general	37,500
Office of Civil Rights	2,790,402
State grants	31,847
Banner Project	<u>689,000</u>

Total	<u>30,631,630</u>
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VSU Cooperative Extension and Agricultural Research Services:

Education and general programs	<u>3,449,462</u>
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Total operating appropriations	<u>\$34,081,092</u>
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Capital appropriations:

Central maintenance reserve	\$ 4,808,000
Gandy Hall renovation bond proceeds	1,020,000
Gandy Hall temporary facility bond proceeds	529,000
Emergency generator	<u>750,000</u>

Total capital appropriations	<u>\$ 7,107,000</u>
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9. AUXILIARY ACTIVITIES

Current year operating revenues and expenses for Auxiliary operations were received and distributed as follows:

Auxiliary enterprises revenues:

Food service	\$ 5,219,181
Residential facilities	7,486,863
Bookstore	257,161
Telecommunications	25,092
Student health services	21,982
Parking and transportation	255,653
Student unions and recreational facilities	27,001
Intercollegiate athletics	312,729
Other auxiliary and sales services	9,398,613
Reserves	<u>505,971</u>

Total auxiliary enterprises revenues	<u>23,510,246</u>
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Less: Scholarship allowances	<u>(5,877,594)</u>
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Net auxiliary enterprises revenues	<u>\$17,632,652</u>
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Auxiliary enterprises expenses:	
Salaries, wages, and fringe benefits	\$ 4,579,065
Contractual services	4,339,597
Supplies and materials	661,795
Property and improvement	20,173
Equipment	455,911
Current charges and obligations	1,078,221
Scholarships	1,380,647
Indirect cost	2,712,712
Other auxiliary expenses	<u>247,632</u>
Total auxiliary enterprises expenses	<u>\$15,475,753</u>

10. EXPENSES BY NATURAL CLASSIFICATION

The following table shows a classification of expenses both by function, as listed in the Statement of Revenues, Expenses, and Changes in Net Assets and by natural classification, which is the basis for amounts shown in the Statement of Cash Flows.

	Salaries and Wages	Fringe Benefits	Services and Supplies	Scholarship and Fellowships	Utilities	Depre- ciation	Total
Instruction	\$15,680,076	\$4,139,545	\$5,839,510	\$124,702	\$147,537	\$ -	\$25,931,370
Research	1,619,905	397,628	770,797	33,688	27,383	-	2,849,401
Public service	2,431,992	618,594	2,291,647	46,457	177,057	-	5,565,747
Academic support	2,760,724	659,344	2,534,273	95,762	34,718	-	6,084,821
Student services	1,979,462	648,267	967,470	54,335	50,775	-	3,700,309
Institutional support	4,365,689	1,658,020	1,774,323	2,291	623,985	-	8,424,308
Operation and maintenance of plant	557,584	194,425	8,143,316	-	2,441,147	-	11,336,472
Depreciation	-	-	-	-	-	7,401,366	7,401,366
Scholarships and fellowships	21,742	-	25,674	1,278,135	-	-	1,325,551
Auxiliary enterprises	<u>3,540,847</u>	<u>1,038,218</u>	<u>7,420,412</u>	<u>1,380,647</u>	<u>2,095,629</u>	<u>-</u>	<u>15,475,753</u>
Total	<u>\$32,958,021</u>	<u>\$9,354,041</u>	<u>\$29,767,422</u>	<u>\$3,016,017</u>	<u>\$5,598,231</u>	<u>\$7,401,366</u>	<u>\$88,095,098</u>

11. COMMITMENTS

As of June 30, 2005, the University was a party to construction contracts totaling approximately \$34,834,522 of which \$17,577,781 was incurred as of June 30, 2005.

12. RETIREMENT PLANS

A. Virginia Retirement System

Employees of the University are employees of the Commonwealth of Virginia. Substantially all full-time classified salaried employees of the University participate in a defined benefit retirement plan administered by the Virginia Retirement System (VRS). VRS is an agent multiple-employer public employee retirement system (PERS) that acts as a common investment and administrative agency for the Commonwealth of Virginia and its political subdivisions.

The VRS does not measure assets and pension benefit obligations separately for individual state institutions. Therefore, all information relating to this plan is available at the statewide level in the Commonwealth's CAFR. The CAFR discloses the unfunded pension benefit obligation at June 30, 2005, as well as the ten-year historical trend information showing VRS's progress in accumulating sufficient assets to pay benefits when due.

The University's payroll costs for employees covered by the VRS for the year ended June 30, 2005, were \$21,846,375. The University's total payroll costs for the year then ended was \$32,958,021. The University's total VRS contributions were \$2,021,052 for the year ended June 30, 2005, which included the five percent employee contribution assumed by the employer. These contributions represent 9.25 percent of covered payroll for the year.

B. Optional Retirement Plans

Full-time faculty and certain administrative staff may participate in two retirement plans: 1) Fidelity Investments Institutional Services and 2) Teacher Insurance and Annuity Association/College Retirement Equity Fund. These are fixed-contribution programs where the retirement benefits received are based upon the employer and employee contributions totaling 10.4 percent, plus interest and dividends.

Individual contracts issued under these plans provide full and immediate vesting of both the University and the participants' contributions. Total pension costs under these plans were approximately \$705,286 for the year ended June 30, 2005. Contributions to the optional retirement programs were calculated using the base salary amount of approximately \$6,781,597. The University's total payroll in fiscal year 2005 was approximately \$32,958,021.

13. POST-EMPLOYMENT BENEFITS

The Commonwealth participates in the VRS-administered statewide group life insurance programs, which provides post-employment life insurance benefits to eligible retired and terminated employees. The Commonwealth also provides health care credits against the monthly health insurance premiums of its retirees who have at least 15 years of service and participate in the state's health plan. Information relating to these plans is available at the statewide level in the Commonwealth of Virginia's CAFR.

14. SPECIAL TERMINATION BENEFITS

Full-time faculty and certain administrative staff participated in Early Retirement Incentive Plan (ERIP) and Alternate Severance Options/Workforce Transition Act (ASO/WTa) through the University in fiscal year 2005. At June 30, 2005, total ERIP payments were \$34,360 for fiscal year 2005 and \$6,329 are due during fiscal year 2006. ASO/WTa payments totaled \$172,061 for fiscal year 2005. There are no future payments at June 30, 2005, under ASO/WTa.

15. CONTINGENCIES

The University has received federal grants for specific purposes that are subject to review and audit by the grantor agencies. Claims against these resources are generally conditional upon compliance with the terms and conditions of grant agreements and applicable federal regulations, including the expenditure of resources for allowable purposes. Any disallowance resulting from a federal audit may become a liability of the University.

In addition, the University is required to comply with various regulations issued by the Office of Management and Budget. Failure to comply with these regulations may result in questions concerning the allowability of related direct and indirect charges pursuant to such agreements. As of June 30, 2005, the University estimates that no material liabilities will result from such audits or questions.

The University has been a defendant in several legal actions. The final outcome is unpredictable at this time, but management is of the opinion that the liability, if any, for these legal actions will not have a material effect on the University's financial position.

16. RISK MANAGEMENT

The University is exposed to various risks of loss related to torts; theft, or damage to and destruction of assets; errors, and omissions; non-performance of duty, injuries to employees; and natural disasters. The University participates in insurance plans maintained by the Commonwealth of Virginia. The state employee health care and worker's compensation plans are administered by the Department of Human Resource Management and the risk management insurance plans are administered by the Department of Treasury, Division of Risk Management. Risk management insurance includes property, general liability, medical malpractice, faithful performance of duty bond, automobile, and air and watercraft plans. The University pays premiums to each of these Departments for its insurance coverage. Information relating to the Commonwealth's insurance plans is available at the statewide level in the CAFR.

17. SUBSEQUENT EVENT

In October 2005, the University entered into a loan agreement with the Virginia College Building Authority (VCBA) to finance or refinance all or a portion of the costs of the Roger's Stadium Renovation Project and the Student Village Housing Renovation Project (the "2005A Project"). The 2005A bonds have a last maturity date of September 9, 2025, with a true interest cost of 4.27 percent. The bonds were sold at a premium resulting in combined available funds of \$4,060,010. The par amount is \$3,840,000 with a net premium of \$220,010.

VIRGINIA STATE UNIVERSITY
STATEMENT OF AUXILIARY ENTERPRISES - REVENUES AND EXPENDITURES
For the Year Ended June 30, 2005

	Food Service	Bookstore	Residential Facilities	Parking and Transportation
Revenues:				
Student fees	\$ 5,078,668	\$ -	\$ 7,232,197	\$ -
Sales and services	140,513	257,161	65,568	255,653
Interest	-	-	-	-
Miscellaneous revenue	-	-	-	-
Rental fees	-	-	189,098	-
Total revenues	5,219,181	257,161	7,486,863	255,653
Operating expenditures:				
Personal services and benefits:				
Personal services	-	-	859,331	47,481
Employee benefits	-	-	214,522	39,657
Total personal services and benefits	-	-	1,073,853	87,138
Other than personal services:				
Contractual services	2,535,169	1,622	1,167,456	(22,464)
Supplies and materials	35,137	-	114,753	1,697
Property and improvement	-	-	-	17,088
Equipment	28,133	-	77,100	17,433
Current charges and obligations	5,619	-	19,748	17,094
Scholarships	-	-	482,512	-
Transfer payments	-	-	-	-
Unemployment compensation	-	-	6,525	-
Indirect cost	656,991	385	580,670	31,660
Individual claims and settlement	-	-	-	-
Miscellaneous	495,918	7,511	530,312	22,196
Total other than personal services	3,756,967	9,518	2,979,076	84,704
Total operating expenditures	3,756,967	9,518	4,052,929	171,842
Excess/(deficiency) of revenues over/(under) operating expenditures before transfers	1,462,214	247,643	3,433,934	83,811
Transfers to other funds:				
Mandatory transfers - debt service	-	-	(180,000)	(23,535)
Nonmandatory transfers	(719,049)	(143,211)	(1,717,998)	-
Net increase/(decrease)	743,165	104,432	1,535,936	60,276
Fund balance, July 1, 2004, as restated	921,228	106,824	1,149,184	427,166
Fund balance, June 30, 2005	\$ 1,664,393	\$ 211,256	\$ 2,685,120	\$ 487,442

Tele- communication	Student Health Services	Student Unions and Recreational Facilities	Other Auxiliary Functions	Intercollegiate Athletics	Reserves	Total
\$ -	\$ -	\$ -	\$ 8,685,943	\$ -	\$ 505,971	\$ 21,502,779
25,092	21,982	27,001	76,071	306,156	-	1,175,197
-	-	-	470,548	-	-	470,548
-	-	-	58,479	6,573	-	65,052
-	-	-	107,572	-	-	296,670
25,092	21,982	27,001	9,398,613	312,729	505,971	23,510,246
83,157	332,464	581,349	781,423	693,647	-	3,378,852
31,832	80,014	134,668	270,923	164,344	-	935,960
114,989	412,478	716,017	1,052,346	857,991	-	4,314,812
(326,035)	93,541	227,084	209,891	453,331	-	4,339,595
10,507	22,402	25,081	270,543	181,675	-	661,795
-	-	-	-	3,085	-	20,173
25,433	70,097	44,043	98,273	95,399	-	455,911
-	2,872	11,178	911,599	110,111	-	1,078,221
-	906	28,454	324,947	575,462	-	1,412,281
-	-	-	(136)	(2,614)	-	(2,750)
-	-	293	5,163	3,068	-	15,049
(16,517)	136,288	243,547	685,653	394,035	-	2,712,712
-	-	-	-	5,000	-	5,000
(30,778)	110,675	193,820	591,307	400,359	(126)	2,321,194
(337,390)	436,781	773,500	3,097,240	2,218,911	(126)	13,019,181
(222,401)	849,259	1,489,517	4,149,586	3,076,902	(126)	17,333,993
247,493	(827,277)	(1,462,516)	5,249,027	(2,764,173)	506,097	6,176,253
-	-	-	-	-	(1,710,231)	(1,913,766)
-	585,624	1,232,892	(5,297,683)	2,452,769	1,275,246	(2,331,410)
247,493	(241,653)	(229,624)	(48,656)	(311,404)	71,112	1,931,077
43,946	85,284	(39,419)	1,620,827	(25,195)	5,768,612	10,058,457
\$ 291,439	\$ (156,369)	\$ (269,043)	\$ 1,572,171	\$ (336,599)	\$ 5,839,724	\$ 11,989,534



Commonwealth of Virginia

Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218

Walter J. Kucharski, Auditor

March 22, 2006

The Honorable Timothy M. Kaine
Governor of Virginia

The Honorable Lacey E. Putney
Chairman, Joint Legislative Audit
and Review Commission

The Board of Visitors
Virginia State University

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying basic financial statements of **Virginia State University**, a component unit of the Commonwealth of Virginia, and its aggregate discretely presented component units as of and for the year ended June 30, 2005, as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the component units of the University, which are discussed in Note 1. Those financial statements were audited by other auditors whose reports thereon have been furnished to us and our opinion, insofar as it relates the amounts included for the component units of the University, is based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of the component units of the University that were audited by other auditors upon whose reports we are relying were audited in accordance with auditing standards generally accepted in the United States of America, but not in accordance with Government Auditing Standards. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the University and of its aggregate discretely presented component units as of June 30, 2005, and the respective changes in financial position and

cash flows, where applicable, thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis is not a required part of the basic financial statements, but is supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of the University. The Schedule of Auxiliary Enterprises - Revenues and Expenditures is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The Schedule of Auxiliary Enterprises - Revenues and Expenditures has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statement taken as a whole.

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS

Internal Control over Financial Reporting

In planning and performing our audit, we considered the University's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the University's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions, entitled "Test and Update Disaster Recovery Plan," "Document Human Resource Policies and Procedures," "Improve Capital Asset Reconciliation Procedures," and "Improve Compliance with Small Purchase Charge Card Policies" are described in the section titled "Internal Control and Compliance Findings and Recommendations."

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express such an opinion. The results

of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

Status of Prior Findings

The University has not taken adequate corrective action with respect to the previously reported finding “Document Policies and Procedures.” Accordingly, we included this finding in the section entitled “Internal Control and Compliance Findings and Recommendations.” The University has taken adequate corrective action with respect to audit findings reported in the prior year that are not repeated in this report.

The “Independent Auditor’s Report on Internal Control over Financial Reporting and on Compliance and Other Matters” is intended solely for the information and use of the Governor and General Assembly of Virginia, the Board of Visitors, and management, and is not intended to be and should not be used by anyone, other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

EXIT CONFERENCE

We discussed this report with management at an exit conference held on April 4, 2006.

AUDITOR OF PUBLIC ACCOUNTS

JHS/kva



VIRGINIA STATE UNIVERSITY

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Vice President for Administration & Finance

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April 7, 2006

Mr. Walter Kucharski
Auditor of Public Accounts
P.O. Box 1295
Richmond, VA 23218-1295

RE: FY 2005 Audit Report Comments

Dear Mr. Kucharski:

Virginia State University appreciates the opportunity to respond to the Status of Project New Horizons Recommendations and the Internal Control and Compliance Findings and Recommendations presented in the audit report for the fiscal year ended June 30, 2005. In accordance with Government Auditing Standards, we are providing the following response for inclusion in your published report.

We also appreciate Auditor of Public Accounts' (APA) acknowledgement of the efforts made by the University to address prior year comments and APA's continued advice and support in improving the controls and making the University's financial operations stronger and more effective. We look forward to the continued consultation with your staff and wish to convey our thanks for their work on this report.

Status of Project New Horizons

The University is aware of the significant amount of work to be completed prior to the July 1 "go-live" date for implementation of the Banner Finance system. The University acknowledges that there are significant risks associated with the project schedule and that these risks must be monitored closely and swiftly mitigated to insure a successful project completion. The University has successfully managed risks and implemented appropriate mitigation strategies as needed during the life of the project and will continue to do so. To ensure risks are monitored closely, the University has updated its Risk Management Plan and will monitor and mitigate risks weekly through the remainder of the project. The University has also taken proactive measures to minimize risks prior to the July 1 go-live date including:

- Hired a full-time VSU Project Manager,
- Assigned additional resources to mitigate recent staff losses and support training, documentation and testing efforts,
- Scheduling a "go-live" assessment by Sungard SCT prior to completion of testing,

- Conducting an Independent Verification & Validation (IV&V) review prior to “go-live”, and
- Utilizing Internal Audit and the Auditor of Public Accounts to review the Banner test plan, test results, and reconciliation procedures to ensure adequate testing is completed prior to implementation.

The University is managing the project in accordance with the project plan that was approved by the Executive Oversight Committee. The technical “rework” efforts (to modify how the project schedule was established in Microsoft Project) have been abandoned in order to devote more time to managing the actual work effort identified in the plan. The University is updating the project schedule on a weekly basis and will make the weekly updated schedule available on the project web site.

The University has made great strides towards the project implementation and remains committed to a successful July 1 “go-live” for Banner Finance.

Test and Update Disaster Recovery Plan

The University fully understands and appreciates the importance of testing and updating its Disaster Recovery Plan (DRP) in accordance with the COV ITRM standard. Although the University performed limited testing of the DRP in the spring of 2004, the University acknowledges that a full testing and evaluation did not occur.

Upon receipt of this item as a possible Management Letter comment, the University Office of Information Technology (OIT) established a Disaster Recovery Team and began the process of updating the DRP and preparing for the required testing. The University plans to complete this work no later than September 30, 2006. Additionally, the University will update and test the plan annually by June 30 of each fiscal year.

Document Human Resource Policies and Procedures

We understand and acknowledge the importance of fully documenting Human Resource policies and procedures. In response to the prior year’s audit, the University initiated a process to document business policies and procedures across the campus with special emphasis in the Administration and Finance and Human Resources areas. Although Human Resources policies and procedures documentation is not complete, substantial progress has occurred. This documentation effort is on-going and is expected to be completed by July 1, 2006.

We are pleased that no exceptions were noted during the audit in the area of Human Resources due to the lack of documented policies and procedures.

Improve Capital Asset Reconciliation Procedures

The University places great emphasis and importance on the reconciliation process in all areas, including Capital Assets. Although the University acknowledges that there were reconciling differences which had not been corrected between the University's Financial System (FRS) and the State's systems-Fixed Asset and Accounting System (FAACS) and the Commonwealth Accounting and Reporting (CARS), the systems were reconciled and have been reviewed annually by the Auditor of Public Accounts. Adjustments were made as needed to the Financial Statements each year. As noted in the comment, most of the reconciling differences had existed for multiple fiscal years. However, the problems noted were never brought to Management's attention until this year (FY 2005). Upon discussions with the APA during the course of the FY 2005 audit, correcting entries and adjustments were made in CARS/FAACS and FRS for all outstanding differences. The University will continue to review and monitor this reconciliation to ensure that all systems are adjusted monthly as the reconciliation is completed.

Improve Compliance with Small Purchase Charge Card Policies

The University acknowledges that two employees made small purchases with their assigned Small Purchase Charge Card (SPCC) and split the payments. Although these purchases were appropriate and necessary for University operations, they did exceed a University imposed limit of \$500 set for these two individuals. In hindsight, the limit for these two cards was probably set too low because of the nature of the purchases made by the individuals (vehicle repairs and parts purchases). However, since the University had over ninety cardholders for the period, we do not believe that these violations constitute a systemic problem but rather the reverse, that the program is functioning in accordance with University and state policies. Virginia State University began a serious effort in 2005 to comply with the State Comptroller's mandate related to extensively using the SPCC when applicable. Our training and review procedures have already been enhanced. The issue of purchase splitting and oversight by supervisors is being emphasized in training by the Purchasing Department and the SPCC Administrator is reviewing purchases to ensure compliance. Cards have been and will continue to be suspended when abuse is identified.

We contend that procedures currently in place, including daily management review of all SPCC transactions (begun July 2005), reduce the likelihood of a re-occurrence.

The University is committed to addressing all of these findings and comments as expeditiously as possible. Thank you again for your continued collaboration and support in improving the Virginia State University.

Sincerely,

A handwritten signature in black ink, appearing to read "Clementine S. Cone". The signature is fluid and cursive, with the first name being the most prominent.

Clementine S. Cone
Vice President for Administration and Finance

cc: Dr. Eddie N. Moore, Jr., President
Mr. David A. Von Moll, State Comptroller
The Honorable Thomas R. Morris, Secretary of Education
Mr. Richard D. Brown, Director, Department of Planning and Budget

VIRGINIA STATE UNIVERSITY

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As of June 30, 2005

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